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Project Report

BRITISH COLUMBIA FINANCIAL REVIEW:

THE ISSUE OF REVENUES AND RECOVERIES

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Executive Summary—Revenues and Recoveries

This report evaluates the way in which the government raises the revenues necessary to pay for its programs. It concludes that the government's failure to address these issues adequately has contributed to an increasing provincial deficit. Specifically, it finds that:

- Personal tax revenues have grown while corporate rates have gone down, on a comparative basis with other provinces.
- Insufficient resources and attention have been devoted to revenue collection, resulting in the missed opportunity for millions of dollars in public revenues.
- British Columbia's tax rates are low relative to other jurisdictions in Canada and there is some tax room available to address the province's serious deficit problem.

The report recommends that the government:

- Improve the adequacy and efficiency of revenue collection systems.
- Establish a central government-wide plan for revenue activities.
- Ensure that fees charged for government services reflect the cost of those services.
- Ensure that the province collects an appropriate return from publicly owned natural resources.
- Develop a common policy on the setting of fees, and revise financial controls to provide incentives for revenue generation.
- Give the Ministry of Finance and Corporate Relations a greater role in revenue collection.

The Issue of Revenues and Recoveries

A. Introduction

This paper considers the various revenue sources and revenue collection procedures by which the Government of British Columbia receives funds to finance the delivery of its programs, as provided in the terms of reference.

In government, the acquisition of revenue lacks the glamour afforded the management of expenditures. As well, by the nature of the process, revenue is collected using only a very small portion of government's total organizational capacity. Taken together, these two factors can result in less than an optimal allocation of attention and resources to revenue functions.

The following chart shows the dollars of provincial revenue from the major sources for the years 1978 to 1991.

A quick glance at the chart reveals the increase in revenue from personal income taxes and sales tax while corporate taxes have remained low through the middle 1980s, increasing in recent years.

Corporate income tax revenues reflect the business losses of the early 1980s which, combined with various tax rate reductions, held corporate tax revenues down throughout

the mid 1980s. The tax rate reductions in 1986 through 1988 were estimated at the time to reduce corporate tax revenue by $65 to $75 million. Part of the reduction was offset by changes estimated to increase revenue by $25 million in 1987.

British Columbia corporate income rates have moved from being among the highest charged by a Canadian province in the late 1970s to being among the lowest in the late 1980s. Current comparative rates are set out later in this paper.

Corporate rates on businesses are sensitive to rates charged in other competitive economies because the tax rate has an impact on the rate of return used to attract investment on the international market. The competition for capital in a global marketplace has led to a reduction in corporate tax rates in all the major economies. Comparison of international rates is a complex exercise because it involves not just the tax rate but the fixed levies on corporations and the deductions allowed. Another complicating factor is the degree of compliance with the published rates achieved in each country.

Not included on the chart are the non-residential property taxes which the province took responsibility for collecting in 1983 non-residential. Rates for school taxes were reduced in 1985 resulting in an annual revenue reduction estimated at $250 million when fully phased in. Corporation Capital Tax was also phased out in the 1985 tax reform. This was estimated to reduce income by $60 million in 1988 when the Capital Tax reductions were completed. In addition, water rental rates for hydro generating companies were frozen; and fuel taxes for some industries were reduced.

Personal tax rates were increased in 1984, estimated to raise $97 million at the time and again in 1987, estimated to raise $184 million. Those increases combined with the effect of inflation on the tax base have increased revenue from personal taxation almost steadily over the period under review.

The other category included on the chart includes motor licence fees, medical service premiums, lottery revenue, investment earnings and other fees. Sales taxes, medical service premiums, and charges for property transfers have increased over the period. Sales taxes increased from 4 per cent to the current 6 per cent. The increase of sales tax from 4 per cent to 6 per cent in 1981 was estimated to increase revenue by $388 million at that time. Gasoline taxes and miscellaneous other charges have increased over the period. Even with the increases consumer tax rates are generally second or third lowest in Canada.

We consider the various revenue areas under the following headings:

- **Revenues**

  General Issues

  Taxation Revenues

Natural Resource Rents

Other Revenues

- **Fees, Charges and Revenues**

A separate paper on Federal/Provincial Cost Sharing considers the impacts of reduced federal payments on policy options for British Columbia.

B. General revenue issues

Inadequate revenue and collection resources

Generally across the British Columbia government (and in other governments) revenue assessment and collection lacks the publicity, attention and access to resources given to program delivery. For example, the Revenue Division of the Ministry of Finance and Corporate Relations is the major collector of government revenues, but is understaffed. Statistics indicate the direct marginal return per additional assessor or collector could be in the order of $400,000 to $500,000 per annum. Indirect benefits including increased voluntary compliance could be as high provided the audit process is focused on compliance as well as increasing revenue. The case load per tax collector in the Revenue Division exceeds 400 cases; by comparison Revenue Canada collectors have a load of 250 cases.

Revenue systems in both the Revenue Division and the Ministry of Forests require upgrading. These are some of the oldest in government. Failure to ensure there are effective computer systems capable of handling the high volumes may cost the government revenue losses.

An example of the large incremental return to investment in the revenue process is the provision of laptop computers to Social Service Tax auditors. Efficiency increases are estimated at 10 per cent—a massive return on investment.

The evaluation process whereby expenditures on revenue personnel and systems are measured against criteria established for evaluation of program expenditures is inappropriate.

The relevant criteria for evaluation of expenditures on revenue resources is whether, on a present value basis, they are expected to return their marginal costs in marginal revenues collected (retained). Because it is difficult to shift back and forth between evaluation of expenditure and revenue issues, revenue issues government-wide should be evaluated at the same time for the government as a whole. This evaluation should be given prominence, a high profile and a greater emphasis in the budget process.

There is significant evidence that neither senior management responsible for resource allocation nor Treasury Board have given the appropriate priority and attention to revenue functions.

We recommend:

- Review of the evaluation process for the resourcing of revenue collection functions to establish a process that:
  - recognizes that a net positive expected present value can justify additional expenditure, subject only to legitimate public policy constraints that might arise from excessive audit or collection activity
  - emphasizes government's commitment to greater revenue assessment and collection
- The resources and staff applied to the revenue reviewed be increased and the marginal return to government be monitored with a view to optimizing the allocation of resources to assessment and collection functions.
- The effectiveness and capacity of revenue systems be reviewed to ensure that the tools exist for effective revenue assessment, collection and monitoring.

C. Taxation revenues

All taxation revenues of the government, as defined in the Public Accounts, are assessed and collected by the Revenue Division of the Ministry of Finance and Corporate Relations. We have also included in this analysis the profits of the Liquor Distribution Branch, Medical Services Plan Premiums and Lottery Fund revenues.

1. Taxation revenues—five year profile

Following are the taxation revenues for 1989/90 and 1990/91 and forecasts for 1991/92, 1992/93 and 1993/94:

	1989/90	1990/91	1991/92	1992/93	1993/94
	Actual		Forecast		
Taxation Revenue	($ thousands)				
Personal Income Tax	3,452.0	4,140.0	4,300.1	4,465.6	4,796.9
Corporate Income Tax	666.0	608.0	615.3	613.8	760.3
Social Service Tax	1,990.0	2,010.0	2,055.0	2,198.9	2,385.8
Motor Fuel Taxes	502.0	555.0	542.0	569.3	599.2
Tobacco Tax	308.0	347.0	445.0	510.0	514.5
Property - Residential School Tax	397.0	301.0	307.0	316.2	325.7
Property - Business School Tax (1)	525.0	555.0	569.0	586.1	603.7
Property - Rural Area Tax	54.0	52.0	50.0	51.5	53.0
Property Purchase Tax	317.0	211.0	295.0	309.8	322.1
Insurance Premium Tax	95.0	104.0	117.0	124.1	132.3
Hotel Room Tax	53.0	57.0	60.0	63.7	67.9
Corporation Capital Tax	4.0	10.0	13.0	13.0	14.0
Horse Racing Tax	6.0	6.0	6.0	6.0	6.0
	8,369.0	8,956.0	9,374.3	9,827.9	10,581.3
Other Taxation Type Revenues					
Medical Services Plan Premiums	641.0	661.0	740.0	775.3	793.9
Lottery Fund Revenues	196.0	205.0	202.5	206.6	211.3
Liquor Distribution Br. Profits	420.0	447.0	452.0	451.5	456.9
Total Taxation	9,626.0	10,269.0	10,768.8	11,261.3	12,043.4

(1) The province began collecting Business School Taxes in 1991. Figures for 1990 were collected for school boards.

2. Personal income taxes

(i) Tax Collection Agreement—British Columbia is party to a tax collection agreement with the federal government. The federal government collects personal income taxes for British Columbia by applying a tax rate established by British Columbia to basic federal tax determined by federal income tax law. All provinces except Quebec are party to the agreement. Provinces are permitted to institute refundable and non-refundable tax credits (non-refundable credits can only be claimed against a provincial tax liability) and surtaxes. As well, the federal government has agreed on a temporary basis to administer fixed flat rate taxes for three provinces.

This system does not provide the provinces with as much tax policy flexibility as they would like. In particular, they cannot set their own tax brackets or non-refundable tax credit levels (such as the basic tax credits, spousal, child and age credits).

The agreeing provinces proposed a change whereby they would use taxable income as defined for federal tax purposes as their base for provincial taxes. This would permit separate provincial credits and rate brackets. The federal government is reviewing this proposal.

The other alternative for British Columbia is to administer its own personal tax system. This would provide even greater flexibility, but with increased administrative costs and the increased burden of preparing an additional tax return by all B.C. residents.

(ii) Social Policy Issues—There are various social policy issues with respect to personal income taxes, for which more tax-based options could be considered if provincial tax was based on taxable income. These include:

- The relatively high tax burdens borne by middle income family units vis-a-vis single taxpayers in the same income strata.
- There are substantial tax advantages for couples with children to live common-law rather than be married.
- The threshold level for loss of eligibility for income assistance is not integrated with the threshold level for taxation. Consequently the aggregate of the tax rate and costs of income assistance reduction (the "tax-back" rate) can exceed 100 per cent, at certain income levels. This impacts the incentive to work and contributes to the possibility of a person having higher disposable income if income assistance were chosen instead of employment.

(iii) Collection and Remittances/Forecasts—Personal income tax is collected by the federal government and remitted to British Columbia. Initial remittances start in February of the relevant year and are based on the second prior year's actual taxes. Updates to payments thereafter are made to reflect revised estimates of basic federal tax as filed and British Columbia's share thereof. As well, the federal government provides forecasts of basic federal tax. These forecasts are used as the basis for British Columbia's personal income tax revenue forecasts. More frequent federal forecasts and access to Revenue Canada collection data for the current and prior years would assist British Columbia in providing more timely revisions of revenue forecasts.

(iv) International Financial Business (Tax Refund) Act—This Act provides for refunds of provincial income tax to the following:

- An international financial business.
- A specialist employed by such a business.
- Another eligible employee of such a business.

The refund to the international financial business is for taxes paid in respect of its international banking and insurance activities in Greater Vancouver. A specialist is defined as an individual who concentrates on a field of international financial activities, is employed 70 per cent or more in the international financial business and was a non-resident prior to such employment.

Each international financial business is limited to five specialist employees. Such a person is eligible for a refund of 100 per cent of provincial income taxes for two years. An eligible employee is any employee of an international financial business 70 per cent or more of whose duties are devoted to the international financial business. It would appear to include administrative and clerical staff as well as those employed directly in providing financial and insurance services. Any eligible employee can obtain a refund of 30 per cent of provincial income taxes paid.

The use of employee tax credits can result in a perception of special treatment for these employees vis-a-vis employees, including clerical staff, not employed in this sector. If it is desirable to attract international financial businesses and assistance is necessary to do so, then the business could be assisted with a refundable credit based on the amount of its payroll for individuals employed in the international financial business.

3. Corporate income tax

(i) Deductibility of Payroll and Capital Taxes—In its 1991 federal budget the Government of Canada proposed to disallow provincial payroll and capital taxes as a deduction for corporate income tax purposes. Newfoundland, Quebec, Ontario and Manitoba levy payroll taxes (a percentage tax on the taxpayer's payroll) and Saskatchewan, Manitoba, Ontario and Quebec levy a general capital tax (a tax on corporate debt and equity capital). All provinces levy capital taxes on financial institutions.

Since payroll and capital taxes are deductible when determining taxable income for corporate tax purposes, the federal government effectively bears a portion of these provincial taxes. Provinces not levying such deductible taxes are at a relative disadvantage. In lieu of a deduction for these taxes, the federal government proposed that all corporations were to be permitted a deduction of 6 per cent of taxable income in excess of $10,000. As a result taxable income for British Columbia companies would be reduced. This would reduce taxes to be collected by British Columbia but provide tax room for British Columbia in respect of the reduced federal taxes to be paid by British Columbia companies. British Columbia could have increased the tax rate on large corporations by about 2.5 per cent and on small corporations by about 1.25 per cent resulting in total increased revenue of from $70 to $100 million per annum. These increases could be phased in over three years on the same basis as the deduction was phased in.

Based on lobbying by Quebec, and to some extent Ontario, the federal government announced in December 1991 that they would delay implementation of the new rules for one year. This will defer the creation of tax room for British Columbia. Thus, the province would not be able to acquire the additional revenue for at least another year.

(ii) Collection and Remittance/Forecasts—Remittance of provincial corporate taxes by the federal government and provision of corporate tax forecasts are analogous to those used for personal income taxes, as described above. Corporate tax forecasts are less reliable than personal tax forecasts because of the volatility of the corporate tax base and corporate earnings. The November 1991 federal government updated forecast has resulted in a downward revision of British Columbia corporate tax revenue forecasts by $123 million and $159 million for the 1991/92 and 1992/93 fiscal years respectively.

British Columbia's corporate income taxes are administered by the federal government in a similar fashion to personal income taxes. Corporate income taxes are calculated as a percentage of taxable income for federal tax purposes. Ontario, Quebec and Alberta administer their own corporate taxes. The provinces that are self-administered have tended to follow federal corporate changes very closely. Current assessing by the federal government has been judged to be effective, hence the increased administration costs of provincial assessing may not be warranted. For instance, British Columbia had studies prepared on self-administration in both 1988 and 1991. These studies did not recommend self-administration.

4. Tax rates—corporate, personal and sales taxes

At Exhibit I are the comparative tax rates charged by various Canadian jurisdictions. British Columbia has low corporate rates, the second lowest personal income tax rate and the third lowest sales tax rate. Only Alberta is generally a lower cost tax jurisdiction for these taxes. Considering Canadian jurisdictions, there is some tax room available to the British Columbia government to increase taxes in one or more of these areas. But consideration of rates in the United States and other competing jurisdictions would also have to be considered.

Exhibit 1
Comparative Tax Rates

ALL CALCULATIONS AND RATES FOR 1991

	Corporate Taxes				Personal Income Taxes		
	Combined Federal and Provincial Rates					Federal & Provincial	
	Other Corporations		Income Eligible for Small Business Deduction	Sales Tax	Provincial Rates (Note 1)	Taxes Payable on Taxable Income of $30,000	$50,000
	Manufacturing	Non-Manufacturing					
British Columbia	38.8	43.8	21.8	6	51.5	6,481	14,619
Alberta	39.3	44.3	18.8	0	46.5	6,424	14,470
Saskatchewan	38.8	43.8	22.8	7	50.0	7,019	15,730
Manitoba	40.8	45.8	22.8	7	52.0	7,102	16,066
Ontario	38.3	44.3	22.8	8	53.0	6,543	14,759
Quebec	30.7	35.7/45.05	16.55	9	-	8,509	17,711
New Brunswick	40.8	45.8	21.8	11	60.0	6,833	15,413
Nova Scotia	39.8	44.8	22.8	10	59.5	6,813	15,367
Prince Edward Is.	38.8	43.8	22.8	10	58.0	6,751	15,227
Newfoundland	40.8	45.8	22.8	12	62.0	6,916	15,600

Note: *All provinces also collect surtaxes and Alberta, Saskatchewan and Manitoba have flat taxes.*

Using figures for 1987/88, the Canadian Tax Foundation developed indices of Provincial-Local Fiscal Capacity and Tax Effort. These are reproduced below.

	Tax Capacity (Own-Source Revenues)	Tax Effort
	National Average = 100	
Newfoundland	61	102
Prince Edward Island	64	95
Nova Scotia	76	92
New Brunswick	72	95
Quebec	86	120
Ontario	109	98
Manitoba	81	113
Saskatchewan	91	103
Alberta	144	77
British Columbia	103	95

Extracted from "British Columbia: Provincial Public Finances" in Melville McMillan, ed., Canadian TaxPayer No. 91, Volume 1, Provincial Public Finances: Provincial Surveys, (Toronto, Canadian Tax Foundation, 1991).

The fiscal capacity measure uses a representative tax system to gauge the relative ability of a province to raise revenues from the available sources. Tax effort measures the relative extent to which each province actually taxes their potential revenue sources. Thus, for 1987/88 British Columbia had a tax capacity 3 per cent higher than the national average and a tax effort 5 per cent lower than the national average. In 1987/88 British Columbia's per capita provincial and local source revenues were 92 per cent of those in Ontario and 89 per cent of those in Canada excluding British Columbia.

This study of tax effort is the most recent one completed. We believe that since 1987/88 when that study was completed, the spread between the British Columbia tax effort and the average of the other Canadian provinces has increased. For instance, the sales tax rate in Ontario has moved to 1 per cent above that charged in British Columbia. Along those same lines, the rates charged to both individuals and corporations has changed so that each are paying more tax in Ontario than in British Columbia now than they were in 1987/88 on a comparative basis. Tax rates aside, the recent recession has had a greater impact on the economies of eastern Canada than on British Columbia, further increasing the difference in relative tax effort between British Columbia and the other provinces.

Using the 1987/88 information in the above table, the tax effort in British Columbia was raising $500 million less than the average of the provinces. No current study is available but based on changes in rates in the provinces since that time the amount has increased. For instance the Finance Ministry data indicates that applying Ontario tax rates in British Columbia rather than the current rates would raise an additional $1.2 billion. Applying Manitoba or Saskatchewan rates would raise $1.6 to $1.7 billion more.

5. Tax increases

Alberta is the only province that borders on British Columbia. It is to Alberta that residents of British Columbia most often look when making tax comparisons. According to the above study, Alberta has the greatest capacity and the least relative tax effort of any of the Canadian provinces. In particular, Alberta's lack of retail sales tax and the lowest personal income tax rates in Canada are particularly visible to British Columbia residents. The higher tax rates of Ontario and Quebec are not commonly appreciated. Thus, the British Columbia government faces a difficult hurdle when attempting to convince its residents that taxes in British Columbia are relatively low in the total Canadian context.

A 1 per cent increase in Social Service Tax ("SST") in 1992/93 could raise approximately $330 million in revenue. This is the most visible of all the taxes. It is also a tax that can currently be avoided by cross-border shopping by lower

mainland residents in the United States and by residents of the northeast in Alberta. If the SST rate is increased, some increase in cross-border shopping must be anticipated.

Retail sales taxes are generally viewed as regressive. The SST contains exemptions for food, children's clothing and certain other essentials and is, in fact, approximately proportional to income. Still, there remains a perception of the tax as regressive.

The above table shows the 1991 provincial personal income tax rates, which are applied to basic federal tax to calculate provincial tax. A rate increase of 1.5 per cent in the British Columbia rate of 51.5 per cent of basic federal tax would increase the rate to 53 per cent, and revenue by about $135 million, giving British Columbia essentially the same personal income tax structure as Ontario. To recover as much as a 1 per cent SST increase would require a 4.1 per cent rate increase in personal income tax. The British Columbia personal income tax rate of 55.6 per cent would then be near the rates charged by the Maritime provinces. British Columbia's present surtax level is 10 per cent and starts applying at about $80,000 of taxable income. Ontario's surtax rate is 14 per cent and comes on at about $85,000 of taxable income. A move toward Saskatchewan's 15 per cent surtax, which starts applying at about $40,000 of taxable income, would generate more income.

A payroll tax in the order of 2.0 to 2.5 per cent would generate approximately $775 million in revenue. No other province has implemented such a tax while retaining health service plan premiums.

Increasing corporate income taxes as a means of generating revenue is subject to several constraints:

- The tax collected is relatively small (about $600 million) and thus a rate increase must be dramatic to provide material revenue increases.
- Corporate rates are a factor in attracting industry to the province.
- The corporate tax base is relatively unstable, varying considerably with the economy and thus is not attractive as a **reliable** revenue source.

Notwithstanding the shortcomings of corporate tax as a revenue generator, there would appear to be tax room in the corporate tax area.

6. Social Service Tax ("SST")

(i) Remittance Period—SST is a major revenue generator ($2.1 billion in 1991/92). Most of the tax is collected from purchasers by registered vendors and remitted by the fifteenth of the month following the purchase. Businesses and or consumers receive an average of approximately 30 days of interest-free financing from the government. As well, some number of businesses will fail

in this period without paying unremitted taxes. Changes to the Bankruptcy Act (Canada) and implementation of the Personal Property Security Act have left the province with a less secured position when attempting to collect unremitted SST.

(ii) Cross-Border Shopping—SST on consumer goods purchased outside British Columbia is not being collected. This causes a loss in revenue for British Columbia as well as encouraging cross-border shopping. Unless the Government of Canada collects SST at the border, there does not appear to be a simple effective solution. The federal government is willing to provide information gathered at the border so that British Columbia can attempt later collection. (Ontario has indicated it will attempt to use this information to collect its sales tax.)

(iii) GST—There are substantial complexities with respect to the possible harmonization of the SST with the GST. The largest plus for harmonization is the greater economic efficiency of the tax and improved competitiveness for British Columbia producers. On the minus side would be the perceived transfer of tax burden and pressure to compensate low income earners (probably with a tax credit) for the broadening of the tax base that would come with harmonization.

(iv) Exemptions—Over the years a number of exemptions have crept into the SST tax legislation. These include such items as bicycles, restaurant meals, home heating fuel, residential electricity, etc. Once such exemptions are given they become very difficult to remove and tend to form a foundation for additional claims for exemption. Ultimately, the tax base could be materially compromised and government options reduced.

(v) SST on Reserve Sales to Native Indians—Native Indians are able to purchase liquor exempted from the 10 per cent provincial sales tax and the 7 per cent federal GST if they purchase it on a reserve. There are two government liquor stores on reserves—one at Park Royal, West Vancouver, and the other in Bella Bella. There is a proposed store on a reserve in New Aigansh and it is proposed to move the Park Royal store off the reserve. The federal government has instructed the Liquor Distribution Branch to stop collecting GST on liquor sales to status Indians on reserves.

We recommend:

- That the Ministry consider more timely remittance of SST by registered collectors, with perhaps a weekly remittance by large collectors and bi-monthly remittance by others. Savings in the order of $10 million are possible.

7. Property purchase tax

By using corporations or trust arrangements, property purchase tax can be avoided on transfers of beneficial ownership of real property, provided there is no change in registered title. It is difficult to change the rules to prevent this avoidance and its possibility restricts the ability to increase the tax rate without encouraging more avoidance.

8. Property tax

Since 1990, all school taxes in the provinces (excepting any that might be imposed by school districts after approval by referendum) are collected by the province and become part of general revenues. Prior to 1990, only non-residential school taxes accrued to the province. As well, the province collects rural area property tax on its own behalf and collects on behalf of hospital and other improvement districts their particular tax levies.

(i) Assessed Values—Currently values on the assessment roll are updated every two years, except for adjustments for additions to the roll or property reclassifications which are updated annually. If residential property values have been unstable, large value adjustments can occur during this period. Where properties have increased substantially in value, taxpayers have often reacted strongly, resulting in pressures to adopt a system to avoid rapid value increases. Often proposed is annual assessment with three year averaging for values.

The foundation of any property tax system is in the quality of its valuations and its responsiveness to changes in value. A system which averaged valuations over years will punish the losers (those whose values have increased the least, or decreased) and reward the winners (those whose property values have gone up the most). As well, British Columbia would move away from a fair market value property tax base - a target which many other jurisdictions are seeking to achieve.

(ii) Property Taxes on Reserves—Native Indian bands were given the power in 1988 by the Indian Act (Canada) to levy their own property taxes on reserves. Band assessment and tax bylaws must be approved by the federal Minister of Indian and Northern Affairs. He is advised by the Indian Taxation Advisory Board, which recommends tax rates similar to rates in surrounding areas. Taxation is applied to properties occupied by non-Natives on areas of reserves designated for development.

The province and municipalities have previously taxed such occupiers and to avoid double taxation passed the Indian Self-Government Enabling Act which reduces or eliminates provincial property taxes once an Indian band tax takes effect. Taxing authorities supplying services to the particular reserve

properties can negotiate a service agreement with the band and, failing reaching agreement, can discontinue services unless Cabinet intervenes.

In 1991, three bands commenced to exercise this taxing power and in 1992 an additional ten bands may do so. The following problems are arising:

- Local governments may have difficulty negotiating service agreements particularly for general services such as parks and recreation facilities and will ask for provincial support.

- 'School taxes' for the particular bands which are included in general revenue and not tied to school access will be lost to the province as will rural area property taxes for the particular bands. It will be difficult to negotiate service agreements in respect of either of these taxes.

This problem is not particularly significant for the province (0.4 per cent of the provincial base) but is of concern to about 25 communities with larger developments on reserves such as Duncan and West Vancouver.

(iii) Tax Collection—Generally tax collection success for property taxes is excellent vis-a-vis other taxes. However, there are two smaller problem areas:

- Tax liability on non-Crown granted lands (leaseholds, rights of occupation, rights-of-way, etc.), can be extinguished by a bankruptcy. Annual bad debts total between $0.5 million and $1 million, with most of these arising on mobile homes which can be moved and be difficult to trace.

- Where a municipality is in financial difficulty, taxes receivable from it may not be collectible. A reserve of about $5 million should be established at this time for taxes receivable from municipalities and reviewed at March 31, 1992.

(iv) Land Tax Deferment Act—This Act permits a homeowner who is 60 years or older to defer payment of property taxes. Deferment is possible on application, provided there is 25 per cent equity in the home on the basis of assessed value at the time of application. If the equity drops below 20 per cent then no further taxes are deferred. Applications for renewal are required annually. Deferred taxes plus interest thereon are a charge on the property. An interest rate is set semi-annually by the Minister of Finance and Corporate Relations (currently 7.75 per cent) and simple interest is charged at the lesser of the rate and prime minus two percent. The program has had no bad debts since inception in 1975. There are currently 4,200 properties, on which a total of $32 million in taxes have been deferred. Many of these properties are in expensive residential neighbourhoods.

(v) Home Owner Grants—The Ministry of Municipal Affairs, Recreation and Housing is responsible for the administration of home owner grants. In the past, there have not been adequate systems in place to detect and prevent abuse of the program such as claims made in respect of ineligible properties. In an effort to reduce abuse the Ministry of Municipal Affairs, Recreation and Housing is establishing a monitoring function which is to be in place, at least in part, for June 1992. The skills and experience to control such programs as the Home Owner Grant already exist in the Revenue Division of the Ministry of Finance and Corporate Relations.

We recommend:

- No change be made from the current value, bi-annual property assessment system now in place in British Columbia.
- The subject of restitution for municipal or school services provided to reserves where self-government has been established be considered in the course of land claim or related negotiations.
- A reserve of $5 million be established now for taxes receivable from municipalities and reviewed again at March 31, 1992.
- The upper cap of prime minus 2 per cent on interest for land tax deferment be reconsidered to ensure it is not used as an inexpensive borrowing source. The rate should be at least equal to, and preferably slightly higher than, the current available investment yield on short-term funds.
- Administration of the Home Owner Grant Act be transferred to the Revenue Division of the Ministry of Finance and Corporate Relations from the Ministry of Municipal Affairs, Recreation and Housing.

9. Motor fuel, tobacco and liquor taxes

Following are comparative motor fuel and tobacco tax rates of the provinces as at January 1, 1992.

	Gasoline Cents/Litre	Diesel Cents/Litre	Per Carton of 200 Cigarettes (1)
British Columbia	9.76 (2)	10.2 (2)	$ 18.80
Alberta	9.0	9.0	14.00
Saskatchewan	10.0	10.0	15.95
Manitoba	10.5	10.9	18.78
Ontario	14.7	14.3	16.00
Quebec	19.5	19.5	14.40
New Brunswick	12.7	13.7	24.04
Nova Scotia	12.3	14.2	17.50
Prince Edward Island	11.7	11.7	18.00
Newfoundland	13.7	15.6	18.95

Notes: *(1) Includes sales taxes where applicable.*

(2) An additional 3¢/litre is levied in the Greater Vancouver transit area. British Columbia has the second lowest tax on gasoline and third lowest tax on diesel (except on the Lower Mainland where they are the fifth lowest) and the third highest tax on tobacco.

(i) Tobacco Tax Levels—The increasing taxes on tobacco are causing taxation problems and possibly contributing to social problems. Theft of tobacco products at all stages of the distribution chain is increasing and violent incidents are more prevalent. Tobacco tax is not paid on stolen and black market cigarettes. It is also believed that smuggling activities are increasing. New Brunswick, with the highest level of tobacco taxes, has had a decline in tobacco tax revenues at least partially attributable to illegal activities.

(ii) Liquor Distribution Branch Profits—For the following reasons the historic growth in profits from the Liquor Distribution Branch is unlikely to continue:

- the delivery trend of reduced alcohol consumption per capita.
- a shift in consumption from higher margin spirits to beer and wine.
- the recent GATT rulings which state that changes will be required to eliminate differential mark-ups on draught beer and restrictions on sale and distribution of foreign beer.

Forecasts for the next several years show only small increases and these could be optimistic in light of the GATT ruling.

(iii) Tobacco Taxes and Native Issues—On June 28, 1991, the Tseshaht Indian Band successfully challenged the province's fuel and tobacco tax quota refund

systems. Prior to the decision, fuel and tobacco tax exemptions were provided to aboriginal people through formal agreements between retailers and the Consumer Taxation Branch of the Ministry of Finance and Corporate Relations. Under the agreements, an established quota of exempt tobacco and fuel products could be purchased tax-free from wholesalers. The exempt products could then be sold to status Indian people and Indian bands from retail outlets located on the reserve. This quota system allowed a control over potential abuse while providing a method of delivering the products tax-exempt to these people.

In the Tseshaht Indian Band decision, the court ruled that Indian people and bands can purchase unlimited quantities of fuel and tobacco products tax exempt, provided the purchase takes place on the reserve.

Given the large potential profits from trading in tax-exempt tobacco products (the current B.C. tax per 200 cigarettes is $18.80) there is a substantial concern with respect to abuse of the tax-exempt right to purchase. Already tobacco tax revenues are down by virtue of increased exempt sales and revenue losses from abuse of the tax-exempt purchases are running at about $900,000 tax per month whereas prior years' losses from abuse were about $215,000 per month. Consumer Tax Branch estimates 1991/92 additional losses from abuse at between $4 and $5 million. It estimates that 1992/93 losses could be in the order of $16 million.

The Consumer Tax Branch is examining alternative solutions.

We recommend:

- The problems being experienced by New Brunswick be investigated and that any future tobacco tax rate increases be made after consideration of the impact on smuggling and other illegal activities.

- Liquor Distribution Branch pricing be reviewed in the context of the recent GATT ruling and shifts in alcohol consumption profiles.

- That the solution chosen to avoid abuse of the ability of status Indians to purchase tobacco products exempt of SST be consistent with the Indian Act (Canada) and be capable of expeditious implementation to minimize foregone revenues.

10. Medical Services Plan ("MSP") premiums

Of the provinces only British Columbia and Alberta levy health care premiums. The other provinces fund all health care from general revenues. Monthly MSP premium rates are $35 for single persons, $62 for couples and $70 for families of three or more. Approximately 60 per cent of premiums are paid on behalf of employees by employers. For approximately 400,000 lower income individuals and

families, an assistance program provides premium reductions of from 15 to 95 percent.

In essence MSP premiums are a form of poll tax which is a regressive form of taxation, although the premium assistance plan does provide some relief. In theory, the progressivity or regressivity of the province's taxes should be viewed in aggregate. In practice, individual taxes will be challenged because of their particular sensitivity to the ability of the taxpayer to pay. Administration of premium assistance requires a separate administrative structure and is relatively expensive.

Revenue targets for MSP premiums were established as 50 per cent of physician billings and 100 per cent of supplementary benefits. If such targets are to be retained, a 5 per cent increase in rates would be necessary for 1992/93.

Four provinces (Newfoundland, Quebec, Ontario and Manitoba) levy payroll taxes as alternatives to Medical Service Premiums. The base for payroll taxes is the wages and salaries, bonuses, commissions and taxable benefits provided employees. Except in Quebec, some relief is provided to smaller businesses. If British Columbia were to use a payroll tax, it would require a rate from 2.0 to 2.4 per cent (depending on relief provided to small businesses) if it were to raise revenues equivalent to MSP premiums.

Under current rules, a payroll tax would be deductible for federal income tax purposes; however, as reviewed above, the federal government proposes to disallow deductions for payroll and capital taxes in the future. In December 1991, the federal government announced deferral of implementation of these provisions until 1993.

Payroll taxes are easy to administer, have a broad base, generate substantial income and would in effect, put the British Columbia tax system on a comparative basis with the other provinces. At the same time, like any new tax, they would result in some shift in tax burden and alter the cost of production in the province. Those could lead to efforts to avoid the tax and have an impact on investment and employment decisions. Consideration of those factors should form part of any decision on this tax.

11. Interest on unremitted and overdue taxes

The current interest rate provided by Regulation 213/83 to the Assessment Authority Act for unremitted or unpaid taxes under most tax statutes (Social Service Tax Act, Tobacco Tax Act, Hotel Room Tax Act, Insurance Premium Tax Act, Taxation (Rural Area) Act, etc.) is prime plus 1.5 per cent. For a taxpayer in financial difficulty, there can be too great a temptation to use unpaid or unremitted taxes to finance a business. This puts the ultimate collection of tax at risk.

We recommend:

- Consideration be given to increasing the rate of interest on unpaid or unremitted taxes to such a level that deferral of tax payments is not an attractive financing option.

12. Corporate minimum tax

There has been ongoing interest in a corporate minimum tax. Currently the Province of Ontario is studying the possible implementation of such a tax. Impetus for the tax is created by corporations that have income on their financial statements but pay no tax. The recent federal tax reforms (1987) reduced such differences substantially but concerns appear to remain.

The federal Large Corporation Tax ("LCT") acts as a form of minimum tax since a portion of income tax paid can be used to reduce LCT and, as well, the British Columbia capital tax on financial institutions acts as a minimum tax, as provincial income tax is creditable against it.

The difference between financial income and taxable income arises because:

- A corporation is claiming tax deductions in excess of accounting deductions—the higher tax deductions were typically introduced as incentives.

- Financial income is for a consolidated group of companies and taxable income is on a non-consolidated basis.

- Loss carry-overs reduce taxable income but not financial income.

- Inter-corporate dividends paid from taxed income are tax-free to the recipient but included in financial income.

The primary tax incentive now provided to taxpayers is to permit tax depreciation to exceed accounting depreciation. The manufacturing sector is the main beneficiary of this incentive. Tax depreciation in Canada after tax reform is slightly less attractive than tax depreciation in the United States.

Typically, a minimum corporate tax is designed to smooth the income of corporations and not increase the tax burden on them in absolute terms. As such, the minimum corporate tax is quite complex to design so that it achieves the desired result and does not harm a sector of industry. Such a tax would require reconsideration of the Tax Collection Agreement or the implementation of a provincial corporate return.

13. Dedicated taxes

The use of taxes which are dedicated to particular programs can reduce resistance to introduction of new taxes. This appears particularly true for environmental taxes. But dedicated taxes have disadvantages:

- They remove flexibility from government and reduce government's capacity to allocate its resources in the optimal fashion at that particular time.

- There can be competing interests for the dedicated taxes and once they are allocated to an interest, to reallocate them, or a portion of them, will be difficult.

Taxes may be introduced to compensate for the market's failure to recognize social or public costs with respect to a specific activity. For example, a tax on batteries can recognize the public costs that will arise on disposal of the batteries and result in a more efficient allocation of resources by the market between battery production and other alternatives. Such a tax serves a useful economic role, whether or not the revenues from it are applied to battery disposal. In other words, there is no requirement to dedicate the revenues from such a tax for it to serve its primary purpose.

14. Transfer of tax points

Where local expenditure decisions will be made, but local tax capacity is insufficient to fund the expenditures, government can consider transferring tax points to the local level to facilitate accountability. Historically, governments transferred the right to impose property taxes to municipalities to assist them in funding operations. Local politicians set the rates, collect the taxes and make local expenditures for which they are accountable to the taxpayers who have elected them.

Where a particular local expenditure is viewed as exceeding the capacity of the property tax base or could be more appropriately funded by a tax more sensitive to the ability to pay, then the government can make grants to support the expenditure. Government could as well transfer tax points, or tax room, to the local government. This was done for Skytrain when the Greater Vancouver Transit Commission ("GVTC") received the capacity to levy a 3¢ per litre tax on motor fuel sales in the transit area.

Since municipal financial information is not consolidated into the provincial public accounts and the prospective value of tax room is not treated as an asset of government, the government's fiscal result could be materially affected by how they choose to assist local projects. For example if sufficient new tax room were transferred to the GVTC which used such tax room to borrow to fund LRT additions, the government would show no costs for the LRT nor reduced revenues.

The Greater Vancouver politicians would be accountable to the Greater Vancouver electorate for the expenditure of any tax funds from the new tax base. Other local jurisdictions may argue for the same tax room, but if the tax room transferred is appropriately chosen it could be made appropriate only to a larger municipality with similar transit needs.

Such a course of action has disadvantages. Once tax room is given up it is difficult to recapture and is no longer available for the provincial government's use in meeting future fiscal requirements. Where there is a perceived need to provide equalization between better and worse off areas of the province, the government will wish to retain taxing powers to accomplish this. Thus, the government collects school taxes and includes them in general revenues. It then provides funding to school districts from general revenues and is able to fund a school district in a disadvantaged area independent of revenue received from this area.

We recommend:

- The government complete an in-depth study of the sharing of taxing power and responsibility with local authorities with a view to improving local accountability and scope for decision-making while maintaining the province's role in ensuring that no areas of the province are substantially disadvantaged vis-a-vis other areas.

15. Lottery fund

Lottery revenues are a form of taxation—and no more a form of 'voluntary' taxes than are taxes on tobacco. (If you consume tobacco you pay tax; if you buy lottery tickets you pay tax.) Lottery taxes are quite high—in the order of 30 to 35 per cent of sales revenues. Studies indicate that lottery taxation is the second most regressive form of tax after tobacco taxes. Studies also indicate that given the expenditure profile for lottery funds to a large extent on cultural and community programs, lottery profits probably benefit high-income groups slightly more than low-income groups. The Lottery Fund thus tends to act as a conduit to transfer income.

Although not part of direct government revenues, gaming activities licenced by government effect the same type of transfers. In fact, the transfer is more direct and more marked since amateur sport and cultural activities receive substantially all gaming revenues. The allocation of net gaming revenues to groups who are fortunate enough to obtain licences is an arbitrary government resource. Approximately $100 million is allocated in this way.

We recommend:

- Termination of the Lottery Fund.
- Repatriation of net gaming revenues to government and inclusion of these in general revenues and allocation of them by means fully accountable to the Legislature.
- Development of a comprehensive grant program to compensate for the loss of revenue to the currently benefited groups.

D. Natural resource rents

British Columbia has extensive resources which are the base for the province's major forest, oil and gas, mining and hydro-electric industries. When these resources are sold, the buyer is charged a fee, called resource rent by economists, in respect of the natural resources used. If the resource in place could be accurately valued, then the assessment and collection of resource rents would create fewer problems.

However, this valuation encounters many difficulties. For trees, there can be the costs to access, cut, remove, and mill the trees before a market price can be determined. Oil and gas reserves must be found, drilled, produced and moved to markets. Mineral and coal reserves must be discovered, extracted, processed and carried to market and hydro-electric potential must be dammed, directed through generators and transmitted through power lines before it is sold.

Thus market prices are substantially removed from the resource and determination of the contribution of the raw unexploited resource to the final market price provides substantial challenges. The different nature of each resource dictates different solutions.

1. Forest rents

The two major revenue sources for forests are timber sales and the Small Business Forest Enterprise Program (SBFEP). Other additional revenues come from royalties and export fees, scaling fees, lease of rangelands and other miscellaneous sources. Resource rents are collected for timber sales in the form of stumpage fees for trees removed from various forms of land tenures—tree farm licences, forest licences, woodlot licences, licences-to-cut and timber sales licences.

Royalties set by regulation are charged on trees removed from timber licence tenures, approximately 8 per cent of harvested timber is subject to such royalties. The major tenures are tree farm licences and forest licences which together account for about 76 per cent of harvested timber. Licensees of tree farm licences and forest licences are required to perform silviculture as part of their tenure and/or cutting programs.

On October 1, 1987 the appraisal method for stumpage was changed to what is called the Comparative Value Pricing System. Specific prices are charged according to the relative value of each stand of timber being sold, termed a cutting authority, and are established so that the average provincial rate charged approximates an average provincial target rate.

Five year picture for natural resource rents

	1989/90	1990/91	1991/92	1992/93	1993/94
	Actual			Forecast	
Natural Resource Rents	($ thousands)				
Petroleum and Natural Gas					
Natural Gas Royalties	63.0	75.0	74.0	86.0	93.0
Permits and Fees	121.0	157.0	86.0	77.0	81.0
Petroleum Royalties	43.0	48.0	46.0	57.0	55.0
	227.0	280.0	206.0	220.0	229.0
Minerals					
Mining Tax	3.0	7.2	1.0	1.0	1.0
Mineral Resource Tax	37.0	2.2	0.5	0.0	0.0
Mineral Land Tax	12.0	10.9	2.9	3.1	2.5
Coal Royalties	13.0	0.0	0.0	0.0	0.0
Mineral Tax Act	0.0	16.3	20.0	22.0	34.0
Miscellaneous Receipts	8.0	8.4	8.5	8.8	8.9
	73.0	45.0	32.9	34.9	46.4
Forests					
Timber Sales	452.0	419.0	438.0	486.9	511.9
SBFEP	147.0	111.0	136.2	150.7	161.3
Logging Tax	46.0	27.6	(9.0)	(20.0)	10.0
Royalties and Export Fees	42.0	32.2	31.5	31.3	31.3
Other Forestry Revenue	10.0	18.9	10.4	9.9	10.2
	697.0	608.7	607.1	658.8	724.7
Water Rentals	236.0	222.0	252.1	289.1	295.6
Wildlife Act	14.0	15.0	16.0	16.4	16.8
	250.0	237.0	268.1	305.5	312.4
Total Natural Resource Rents	1,247.0	1,170.7	1,114.1	1,219.2	1,312.5

To do this a value index, determined as the difference between estimated sale price of merchantable species and estimated production costs applicable thereto, is established for each cutting authority. Data obtained from a cruise and various prescribed rules are used to establish estimated selling prices and estimated production, or operating costs. A mean value index is then calculated as a volume weighted average for all cutting authorities on the Coast (about 500) and another mean value index is calculated for all cutting authorities in the Interior (about 2,000).

The stumpage rates for a particular cutting authority is determined by taking the difference between that cutting authority's value index and the applicable (Coast or Interior) mean value index and either adding or subtracting this difference from a "base rate". The base rate is the target rate adjusted to recognize elements that bias the calculation such as a prescribed minimum stumpage rate and other special stumpage rates. The initial target rates were set on October 1, 1987, as $10.59 per cubic metre for the Coast and $8.59 per cubic metre for the Interior. These initial rates were set in consideration of several factors, the primary one being the desire to eliminate federal tax on softwood lumber exported to the United States. The target rate is adjusted each quarter to reflect changes in the price of lumber products as determined from relevant Statistics Canada indexes.

The stumpage system is so structured that the target rate will be achieved; however, total stumpage revenues will be sensitive to both volume and the target rate. To the extent a particular operator is successful in reducing his value index, and thus his stumpage rate, other operators on the Coast or in the Interior, as applicable, will have their stumpage rates increased to compensate.

Stumpage charged, after all the calculations (2,500 rates for 2,500 difference volumes), will not necessarily equal the fair value of the timber removed from the cutting authority. In fact, the operator may be over or under-charged. On average, the Ministry is of the view that stumpage charges are above market value. Where stumpage charged is not equivalent to value there will be distortions in the system. Those being under-charged will attempt to maximize their volumes; those being over-charged may well reduce their cut or go out of business due to losses.

In the Small Business Forest Enterprise Program there is a larger element of market-based pricing. Cutting rights are offered to eligible operators who bid on the rate of stumpage to be paid, subject to a floor price. The SBFEP was designed to provide smaller operators and value-added producers access to timber resources. Some of the operators in-turn sell finished or partially finished material to the large producers. For the SBFEP the Ministry is responsible for basic silviculture, road construction and maintenance and other forest management requirements of harvest areas. Stumpage collected, less expenditures for the above activities, reflects government's net returns from the SBFEP harvest lands. The public accounts show SBFEP revenue on a gross basis, which overstates the relative contribution of the program vis-a-vis other stumpage revenue sources.

Since government is responsible for not only collecting revenue from the SBFEP but the overall forest management of SBFEP lands, there should be an accounting convention that encourages accountability for such management. Such accounting convention should:

- Capitalize assets such as roads on a parcel by parcel basis.
- Deplete assets against production.

- Accrue silviculture liabilities.

- Recognize revenue annually and compare net stumpage realized against targets established for each parcel.

The object of such accounting would be to provide accountability for the longer-term management of forest resources allocated to the SBFEP. Evaluation would be of overall management results as reflected by the financial statements.

2. Land tenures

A major constraint on optimal management of the forest resource is the existence of present tenures and the conflict between land use prescribed by such tenures and the developing public perceptions as to appropriate land use. This conflict leaves the Ministry of Forests in a position of being unable to implement unequivocal management objectives for much of the forests under their control. Without a drastic and perhaps costly initiative to restructure the tenure system, managing the forest resource in a sub-optimal fashion will be unavoidable.

The government might offer competitive bid supply contracts for various length terms. The contract would provide for supply of particular species at a particular location in the province. To satisfy their supply contracts, the province could tender short-term logging contracts to loggers who would harvest from areas designated by the government. Alternatively, a process like that used for the SBFEP could be used to tender harvest areas on either a stumpage bid basis or a cruise-based value basis. Under this arrangement the province would have to meet the needs of forest management and reforestation.

3. Revenue administration

The revenue assessment and collection process for stumpage is extremely complex. Quarterly 2,500 different tax rates have to be determined for 2,500 changing tax bases. Physical measurement scaling is necessary for products produced which must, as well, be identified with the appropriate cutting authority, to determine the applicable stumpage rate. Cruises of cutting authorities and appraisals of operating costs are necessary for the pricing model. Most of this work must be done in the field and thus the revenue assessment function is distributed throughout the province and the Ministry. As well, revenue collection is distributed over the province.

Cruising and scaling operations are both conducted by private lessees. The Ministry audits these activities by performing check cruises and check scales.

At present, check cruising is a district responsibility; check scaling is a regional responsibility. Collection starts in districts, but if there are problems it moves up to the region. Valuation and pricing are performed in Victoria and preparation of bills are done in Victoria and sent to the regions for review before transmittal.

As well, responsibility in the Ministry for revenue functions is divided between the Operations Division and the Management Services Division, with the result that there is no division accountable for the overall revenue function.

With the present stumpage system, the revenue function must be integrated with field operations to be effective. There is a need for a headquarters branch to be responsible and accountable to the executive for **all** revenue policies, systems, training and monitoring of performance. In the field, either a region or a district should be responsible for a particular function, have the resources to satisfy the responsibility and a region or district management should be held accountable for the performance. To do this, performance must be centrally monitored and, where unsatisfactory, corrective action taken.

The allocation of responsibility to, say, regions, without the resources to perform the duties will result in reduced accountability and lost revenue. For example, the Regional Cruise Coordinator is responsible for check cruising, but resources for check cruises must be obtained from districts. Similar problems exist for waste surveys. To the extent feasible, responsibility and capacity to satisfy that responsibility should be co-located. This would indicate that responsibility for functions should generally be moved down to districts.

(i) Assessing—The functions of check cruising, review of submitted cost data, check scaling, control of timber marks, other methods for control of product from cut to scale, theft prevention and waste surveys are all part of the audit process to ensure that appropriate stumpage is being assessed. Stumpage is essentially determined by self-assessing, a process analogous to an individual determining his income tax liability by preparing his own tax return.

As for taxes, increased audit activity will result in both increased direct stumpage assessment and higher levels of compliance. But because of the structure of the stumpage calculation, increased stumpage assessed on one lessee generally will cause reduced assessment of other lessees and no net revenue gain to government. Audit activity will increase total revenue when it identifies wood product that is avoiding the scale.

Although much of the result of increased audit activity will not be greater net stumpage revenue, if the system is to continue to operate without over-charging complying lessees, vigilant audit checking is necessary. Failure to maintain a satisfactory over-all level of compliance will result in a breakdown in the current system. There are analogies to the income tax system where complying taxpayers can expect to pay higher taxes to compensate for tax avoiders.

Revenue gains are possible if unscaled wood products can be identified and charged stumpage. This involves detection situations where volume is under-scaled and where Crown timber is illegally removed. The Ministry has increased its efforts to deal with evasion and theft (termed trespass). Forest

Revenue Inspection Teams ("FRITs") have been established to police compliance with the Forest Act. Initial results indicate that trespass, and loss, may be a larger problem than generally perceived.

In addition to the organization issues with respect to the revenue function reviewed above, the level of resources available for and applied to various revenue audit activities should be reviewed. For example, restrictive travel budgets for check scale teams limit the ability to visit remote sites; cruise checks will review only 1 per cent of plots cruised if targets are met; and shortage of staff for waste surveys will cause loss of waste revenues.

The identification and prosecution of trespass should be more vigorously pursued by the Ministry.

(ii) Collection—There are two aspects to the failure to collect accounts. Firstly, the poor creditworthiness of some operators with whom the Ministry does business; and secondly, the failure to bill promptly and to actively pursue collection of accounts receivable on a timely basis.

Poor credit risk is primarily a problem in the SBFEP. Small businesses that meet the technical requirements are entitled to bid and the Ministry is obliged to accept the highest bid, even if the bid price is so high as to be economically not viable. In such a case, there may be no assets left after harvesting is complete from which the Ministry can recover what is owed.

If a small business has an outstanding account, the Ministry will not sell further timber to that business. However, the principals may form a new corporation and use it to bid on a sale, possibly circumventing the Ministry's policy.

The Ministry has not successfully achieved a Ministry-wide and consistent standard for the collection of accounts receivable. Clear and consistent policy guidelines that provide for an active effort to collect overdue accounts need to be established and monitored. District managers should be responsible and accountable for collection performance.

The Ministry proposes to seek Treasury Board approval to increase interest charged on over-due accounts above the present prime plus one-half per cent. We concur with this initiative.

We recommend:

- A separate accounting convention be established within the general fund for the SBFEP to permit more effective inter-temporal management and accountability for the operation of the program. Such a convention would provide for parcel-by-parcel accountability, capitalization and depletion of assets and carry-over of surplus.

- The present tenure system be reviewed to investigate ways in which it may be improved so that it satisfies the needs of the forest industry, while providing the government the flexibility to manage the forest resource in a manner compatible with evolving values and technology.

- A headquarters branch be established that has overall responsibility and accountability for the revenue function in the Ministry. Responsibility for particular aspects of the revenue process should be clearly defined, delegated to the district level, supported by sufficient resources, monitored to measure performance, and subject to corrective action if unsatisfactory.

- A review be conducted of the resources available and applied to the various revenue audit activities, with a view to ensuring that levels of compliance are sufficient to maintain confidence in the integrity of the stumpage system.

- The Ministry more vigorously pursue and prosecute theft (trespass) of Crown timber and the Ministry centrally monitor the disposition of all cases, including revenue recovery and penalty statistics.

- The responsibility for approval of credit for the actual collection of accounts and following up on delinquent accounts be transferred to the Ministry of Finance and Corporate Relations.

4. Mineral rents

Mineral rents, with the exception of relatively minor revenues collected on sand and gravel under the Mining Tax Act, are collected by the Ministry of Energy Mines and Petroleum Resources. The major revenue statute is the Mineral Tax Act which was introduced on January 1, 1990, and replaced the Mineral Resource Tax Act and parts of the Coal Act, Mineral Land Tax Act and Mining Tax Act. The Mineral Tax Act provides for tax in respect of minerals and coal production (including production of most industrial minerals but excluding sands, gravel, rocks and clays). The Mineral Land Tax Act taxes minerals located on freehold lands and is a relatively minor revenue source ($2.9 million in the current year).

Mining rents are not a major source of government revenue and are a relatively small proportion of total mineral production. In 1990, revenue of approximately $45.0 million arose on production of $3,049.9 million.

The Mineral Tax Act provides for a two tier tax. The first stage, or Net Current Proceeds Tax, is a tax of 2.0 per cent for metals, or 7.5 per cent for coal, on the amount by which current year's revenues exceed current year's operating costs (excluding interest, asset lease and capital costs). The second tier tax applies to Net Revenue. No tax is payable unless cumulative revenues exceed cumulative expenditures. Cumulative expenditures exclude interest, but include capital costs

plus an imputed yield calculated on the net investment from year to year. The Net Current Proceeds Tax plus imputed interest is creditable against any Net Revenue Tax liability. The Net Revenue Tax rate is 13.0 per cent for metals and 17.5 per cent for coal. Introduction of the Mineral Tax Act in 1990 reduced the mineral rents paid to the province from coal production but were revenue-neutral for base metals production.

At present the following are the only material assessing or collection issues with respect to mineral rents:

- Doubtful debts for the current fiscal year in the amount of $12.1 million which have been recognized by the Ministry.

- A dispute regarding $1 million of interest in respect of a refund of taxes.

We recommend:

- Further consideration of the appropriate level of economic rent the province should seek to obtain from mineral resources in light of the contribution of the mining industry to the economy of the province, economic development assistance provided to mining ventures, government costs to regulate the industry and the downstream environmental risks associated with mining, .

5. Petroleum and natural gas rents

There are four sources of petroleum and natural gas rents administered by the Ministry of Energy, Mines and Petroleum Resources:

- Proceeds from sales of Crown reserves whereby leases of from four to ten years are disposed of each month by closed bid competition ($121 million in 1990/91).

- Annual lease rentals from tenured lands and other fees ($36 million in 1990/91).

- Petroleum royalties ($48 million in 1990/91).

- Natural gas and natural gas by-product royalties ($72 million in 1990/91).

Bid bonus dispositions of petroleum and natural gas leases is a market-based, effective manner of collecting resource rents when combined with production royalties. It is administratively straight-forward and creates no assessment or collection problems. There are no particular problems with assessment and collection of petroleum or natural gas royalties. The Audit and Valuations section of the Petroleum Revenues Branch review all Crown royalty returns and performs

field audits. In 1990/91, 548 assessments were issued and additional revenues in excess of $2 million were collected.

The structure of petroleum royalties is such that they are not particularly sensitive to price. When petroleum prices are low, as they currently are, generally revenue is not foregone; however, if prices were to increase the province would realize less than full economic rent for its resource. The appropriate time to restructure is when prices are low.

The market for natural gas is weak and in 1990 the Ministry implemented a posted minimum price as provided for in the Petroleum and Natural Gas Royalty Regulations to the Petroleum and Natural Gas Act. This protects the Crown's revenue share from discount pricing of natural gas.

We recommend:

- A review of the structure of both petroleum and natural gas royalties to ensure that royalties are sufficiently sensitive to price and production cost so as to return economic rent to the province while not imposing inappropriate production disincentives.

6. Water resource rents

The Ministry of the Environment, Lands and Parks collects fees in respect of the water usage for domestic, industrial, irrigation, mining, power and other uses. Regulation 204/88 prescribed by section 45 of the Water Act, R.S.B.C., c.429, schedules the fees to be collected. In 1991/92 such revenues will total $246 million, of which substantially all will relate to power use. Power usage fees are based on capacity and power output (both of which are indexed) and on storage capacity. Fees for use of water in generating power are collected primarily from a few large corporate power users and are based on annual returns submitted by power users. The Ministry does not audit these returns due to inadequate staff resources.

Based on recommendations of the Auditor General in 1987, the Ministry requires the filing corporation to provide a prescribed independent audit certificate confirming the appropriate information on the annual return. In a letter with respect to its audit of the 1990/91 fiscal year, the Auditor General has noted that some of the major power users are not submitting the audit certificate. As a result, the Ministry does not have the necessary assurance that all the revenue is being collected.

British Columbia's water usage fees are the highest in Canada, 17 per cent greater than the next highest province and twice the national average. The determination of the appropriate level of water rentals is made difficult by factors internal and external to the province. Essentially water rentals flow directly to electricity prices and water rental and electricity pricing policies should be considered concurrently.

British Columbia does not licence or impose resource rents on groundwater usage. Groundwater is a semi-renewable resource and licensing should be instituted to provide more information for control purposes. As well, groundwater is a provincial resource with value and a resource rent should be levied on its use.

Surface water users pay in aggregate about $3 million in fees per annum. The Ministry's cost to monitor the resource is about $11 million per annum. The Ministry is proposing to increase fees by 300 per cent over the next few years.

We recommend:

- The Ministry ensure that independent audit verification of returns by major power users is occurring and that the Ministry is receiving appropriate certification to that effect.
- Consideration be given to giving the Ministry of Finance and Corporate Relations responsibility for the audit and collection of user fees.
- A review of the structure and level of water usage fees be completed and be undertaken in conjunction with a review of pricing policies for electricity.
- Licensing and fees be imposed to collect economic rent for the usage of groundwater.
- Non-power surface water usage fees be reviewed to ensure that they approximate economic rent levels.

7. Wildlife licence fees

The Ministry of Environment, Lands and Parks issues licences for hunting, fishing and related activities under the Wildlife Act, R.S.B.C., c.57. Approximately one million licences will be issued in 1991/92 and revenue of $16 million will be collected. The Government Agents Branch of the Ministry of Economic Development, Small Business and Trade distributes, issues and accounts for licences under an agreement with the Ministry of Environment, Lands and Parks. There are 61 Government Agents and 1,300 commercial sub-issuers who receive a 10 per cent commission of the fee revenue.

The Ministry completed a review of the level of fees and licences under the Wildlife Act in the 1990/91 fiscal year.

In the past there have been problems with Ministry control of licences. The Ministry has addressed these problems. We have no recommendations in respect of Wildlife License Fees.

E. Other revenues

1. Licences, permits and fees

Five year revenue data for licences, permits and fees

	1989/90	1990/91	1991/92	1992/93	1993/94
	Actual		Forecast		
	($ thousands)				
Motor Vehicle Licenses and Permits	183.0	199.0	222.0	236.9	247.5
Other Fees and Permits	271.0	250.0	298.5	310.4	324.4

Motor vehicle licences and permits are administered by the Ministry of the Attorney General and Solicitor General. ICBC collects motor vehicle licence fees and remits 95 per cent of the funds collected to the Ministry. In the past the Ministry has had no way of verifying that ICBC was collecting all monies due for licences and that the appropriate amounts were being remitted by ICBC. The Ministry is addressing this issue.

Motor vehicle licences and permits are collected under the Motor Vehicle Act (51 per cent). Commercial Transport Act (45 per cent) and the Motor Carrier Act (4 per cent). Increases in fees at January 1, 1992 for driver training school and other activities will raise annual revenues by $7.5 million.

Other fees and licences will produce 1991/92 revenue of $298.5 million and are raised by various ministries. They include:

	Millions
• Ministry of Attorney General and Solicitor General fees, including land registry fees ($35 million); probate fees; public trustee fees, sheriff's fees; etc.	57.7
• Crown Land Special Account revenues in respect of Crown land sales	42.0
• Ministry of Health fees, including ambulance service fees, Vital Statistics Branch fees, hearing aid equipment sales and Public Health inspection fees	25.8
• Farm Income Assurance Fund; including federal government payments through tripartite agreements	29.9
	155.4

	Millions
Other Fees and Licenses.	
Corporate, Central and Manufactured Home Registry fees	25.0
Coquihalla Highway Tolls	30.0
Safety Inspection Fees	14.0
Public Gaming Licence Fees	11.0
Provincial Treasury Special Accounts	18.4
Securities Commission Special Account	8.2
Insurance and Risk Management Special Account	10.8
Fire Services Act	5.2
Liquor Licensing Branch	5.0
Waste Management Fees	3.8
Heritage Site and Museum Fees	2.3
Camping permits and Park Use	0.8
Insurance Brokers, Real Estate and FICOM	2.9
Miscellaneous Fees and Licenses	10.0
	298.5

It is our perception that, by and large, ministries are aware of fee levels and follow-up on opportunities to increase fees. The recognition and responsiveness in initiating new fees does not appear to be as high. We would note, however, that the Ministry of Environment Lands and Parks has been pro-active in this regard and presented $14.6 million in revenue initiatives for the 1991/92 year including expansion of waste management fees ($0.6 million); new hazardous waste management fees ($1.4 million); new environmental levies on dry cell batteries and white goods ($1.8 million); industry recycling contributions ($4.0 million); and, retention of unredeemed deposits on beverage containers ($7.0 million).

None of these initiatives proceeded last year but, with the exception of levies on dry cell batteries, all are current Ministry initiatives. Additional initiatives this year include a tax on agricultural pesticides, a tax on appliances, a tax on gasoline, park user fees and park vehicle permits. Although there may be practical problems in successfully implementing some of these proposals, the initiative indicated by their advancement is praiseworthy.

These levies would be credited to the Sustainable Environment Fund, a special account administered by the Ministry of Environment, Land and Parks.

2. Fines and penalties/miscellaneous revenue

This section considers fee levels and makes recommendations in respect of fees charged by government.

Revenue from fines and penalties and miscellaneous sources are forecast as $88.0 million and $107.0 million respectively for 1991/92. The Ministry of the Attorney General and Solicitor General administers fines and penalties.

The five year data are as follows:

	1989/90	1990/91	1991/92	1992/93	1993/94
	Actual			Forecast	
	($ thousands)				
Fines and Penalties	45.0	70.0	88.0	92.0	96.6
Miscellaneous Revenue	96.0	143.0	107.0	88.2	91.3

The large increase in 1990/91 in fines and penalty revenues are attributable to the introduction of fines for moving motor vehicle violations.

Fines and penalties are not being collected efficiently. When fines were introduced for moving motor vehicle violations, accounts receivable rose dramatically without a concomitant increase in resources to manage and collect these receivables. The Ministry has introduced a policy of not renewing drivers licences where the driver has unpaid fines. But drivers licences are only renewed every five years. The Ministry is currently examining the possibility of not renewing motor vehicle licences when the registrant has unpaid fines. However, it is difficult to identify cars associated with particular drivers and more difficult to identify all drivers covered by a particular car insurance policy.

Within the last two years both the Auditor General and the Internal Audit Services Branch of the Comptroller General have reviewed the problem of collecting fines. The Ministry, within the capacity of its personnel and systems resources, is attempting to cope with the problem. Both audits were critical of the lack of vigour with which the Ministry pursued fine collection, a criticism with which the Ministry disagreed.

Collection of fines is another area of government where the application of additional staff and system resources may provide a substantial return.

The category 'miscellaneous revenue' in other public accounts contains various other revenue sources often of a one-time nature. For example, it includes recoveries from the federal government in respect of maintenance of children (a recurring amount); a one-time $22.0 million payment from B.C. Gas in respect of a tax agreement related to the sale by B.C. Hydro of its Mainland Gas Division; $10 million in recoveries of loans previously written-off; $11.0 million in receipts for insurance claims; and $10.2 million in payments by municipalities in respect of joint services programs.

We recommend:

- The Ministry pursue all available economic means to collect accounts receivable, including the possibility of not renewing motor vehicle licences where a registrant has unpaid fines.

- A review of the net revenue that might be realized if additional resources were applied to accounts receivable control and collection and, if positive, the allocation of the appropriate additional resources.

3. Other government revenues

The following government revenues have been considered separately as noted:

Interest Revenue	- See the report on the Treasury Function
B.C. Hydro and other Crown Corporations	- See the issue paper on Crown corporations
Contributions from the Federal Government	- See the report on Federal/Provincial Cost Sharing.

F. Fees, charges and recoveries

1. General

Increased revenue, and the resulting opportunity to increase services, is a major motivation to charge for government goods and services. But increased revenue may be a less important consequence of imposing fees or charges than the reduced demand that occurs when a good or service is no longer free. In addition, putting an appropriate price on a good or service is likely to increase economic efficiency—the effectiveness with which resources are used to create goods or services. In general, economic efficiency is maximized when goods are priced at the marginal cost, the cost incurred to produce the last unit of output.

Government charges for goods or services for various reasons:

- To increase revenue.
- In recognition of the economic efficiency that is created by the market place.
- To recover costs.
- To charge those in receipt of a benefit for the benefit.
- As a nuisance charge to reduce desultory demand.
- To recognize that there are costs not included in market prices.

The pressures to increase revenue without increasing taxes have led governments to look more closely at opportunities to charge for goods and services. Thus, in the British Columbia government there have been increasing revenues, or recoveries, in respect of various goods or services provided and the government has established policies in respect of fees and licences.

How motivated a branch will be to propose fees or charges will depend on its perception as to the impact of the increased revenue. If the revenue will be returned to the branch's program so that it can increase services, there is a strong incentive to press for higher charges or to initiate charges. On the other hand, if revenues go into the Consolidated Revenue Fund, with little or no recognition for the program that has produced the revenues, there will be less incentive, or perhaps a negative incentive to institute changes. Negative incentives arise where program funds must be spent to generate revenues which are not returned to the program or are perceived as not recognized in future allocations of resources to the program.

2. Enterprise accounting

To provide recognition for revenues generated by their activities, various programs already account for, or wish to account for, both their revenues and expenditures on an entity basis. Crown corporations are examples of entities that already do so. Special accounts in the general fund are an attempt to do the same thing. There are pressures to provide accounting conventions in government that will permit branches providing services to the public to establish prices on a more rational basis and increase accountability for both revenue and expenditure performance.

We believe that government should more fully recognize the benefit of accounting as a management tool and encourage the development and acceptance of management accounting conventions in government. The establishment of a management accounting convention would not require any change to the present method of preparing the public accounts. But accounts prepared on an enterprise basis would permit more rational pricing decisions, creation and monitoring of longer-term performance targets and improved accountability. A few examples of government enterprises that provide services to the public that could benefit from this form of reporting include:

- The Financial Institutions Commission.
- The Corporate Registries.
- The Small Business Forest Enterprise Program.
- The B.C. Securities Commission.
- The Public Trustee.

Accounting for such activities on an enterprise basis would not reduce the obligation to monitor and control expenditures or the level of charges by these enterprises. It would provide a more rational framework for such monitoring and control.

3. Recoveries

Certain branches of government produce goods or services that have an economic value in the market place. Goods such as systems software and information are examples of assets that may be produced in the process of program delivery but have a value to third parties. Typically proceeds from the sale of such goods will not be returned to the program area where they were developed but expenditures from the program will be required for their sale. Program management thus has no incentive to pursue their sale. We believe that program management should be encouraged to market such goods. Recovery of actual selling costs, plus some small percentage of profits to defray administrative expenses (perhaps 10 per cent), could provide the incentive. Control of such an arrangement might be achieved by creating a group in the Purchasing Commission to establish policies and monitor results.

A similar lack of incentive exists in respect of redundant assets. No proceeds of sale are realized by the branch that takes the time to recognize and initiate a sale of such assets by the Purchasing Commission. A small commission of the sale price (say 10 per cent) could be returned to the branch to help defray the administrative burden. (Too large a commission could create an incentive to sell assets of continuing value to the branch).

4. Inter-ministry charges

In the same way that pricing goods that are provided to the public creates efficiencies, inter-ministry charges can accomplish the same objective. When goods or services are free, the demand for them will be artificially high. As well, the transfer of goods or services at no charge between programs impairs the capacity to control expenditures and accountability to Treasury Board of both the transferor and transferee.

We understand that to process a journal voucher for an inter-ministry transfer is estimated to cost about $50. Thus, large charges are viewed as justified but small charges as causing needless government expense. As well, an acquisition at a price within government may require more senior levels of approval than an acquisition from the private sector and thus there is a built-in incentive to avoid inter-ministry transactions.

Enterprise accounting is an equally valid concept for branches or divisions providing services internal to government. Examples of situations where enterprise accounting could be applicable include the Provincial Treasury and the Risk Management Branch.

5. Pricing

Since government has a monopoly on the provision of many goods and services, pricing can be difficult. Public pressures will normally act as a counter-balance if government attempts to over-price monopolistic goods or services provided to the public. When goods or services are provided internally such counter-balance may not exist and inter-program pricing in a monopolistic situation within government may be too high, leading to excessive revenues to the supplier and, if not closely controlled, excessive expenditures and inefficiencies in the supplier's operations.

Given the wide variation of circumstances in which government provides goods and services, it is impossible to provide a single pricing rule. For example, the rule used to establish ferry prices would not be viewed as appropriate for university fees. Government has a policy of annual review of fees and licences on an individual basis. We believe a government-wide review of the level of fees and charges, together with an economically valid rational for such charges, should be developed.

Some general rules of thumb that could be considered include:

- Where a program exists to regulate private sector activity, full program costs, including fixed asset costs, be recovered.

- Where Crown-owned natural resources are being developed, economic rent be collected.

- Where utility-type services are provided by government enterprise (B.C. Hydro, B.C. Ferries, etc.) marginal cost pricing generally be used; however, if the utility is competing with private sector utilities subject to regulated prices, then average cost pricing as imposed by the applicable utilities commission be used.

- Where non-market competitive government goods or services are provided and there are neither recognized externalities nor distributional objectives, prices be set on the basis of estimated marginal costs.

- Where market-competitive goods or services are provided, the goods or services be priced at market.

- Where goods or services are provided that result in perceived external benefits (for instance higher education) such externalities be recognized when pricing.

- Where market prices fail to recognize external costs borne by government (for example disposal of wet-cell batteries or pollution clean-up) a fee or tax on offending goods or activities should recognize marginal costs to be borne by government.

6. We recommend:

- A management accounting convention be established to provide increased accountability and assistance in pricing for appropriate government enterprises.

- A policy be established that provides a positive incentive for all government programs to exploit revenue opportunities that are not now being identified and followed-up, including an incentive for the disposal of redundant assets.

- Inter-program charges generally be used and the method of accounting for, and approval of, such charges be developed with a view to minimizing internal costs.

- Where internal government services are provided on a monopolistic basis, particular attention be paid to the level of charges.

- A government-wide study of both internal and external fees and charges be undertaken with a view to establishing criteria for when a fee is to be charged and the amount, if any, of that fee.

- The collection of revenue be given more prominence in the program review and audit of government enterprises.